ASCRI comments on "ESMA Consultation Paper July 2011/ESMA/2011/209"

This document has been prepared considering only those of the ESMA's questions regarding the "regulatory" development of the Directive that the representatives of ASCRI have believed that could affect its members. ASCRI fully supports the submission that will be filed by the European Private Equity and Venture Capital Association (EVCA) on behalf of the Public Affiars Executive (PAE) of the European Private Equity and Venture Capital Industry and would like to draw ESMA's attention to this submission for further details.

III.I. Article 3, Exemptions. Identification of the portfolio of AIF under management by a particular AIFM and calculation of the value of assets under management

Question 1

Does the requirement that Net Asset Value prices for underlying AIFs must be produced within 12 months of the threshold calculation cause any difficulty for AIFMs particularly those in start up situations?

As stated in the answer to question 3, ASCRI disagrees with the use of the NAV (Net Asset Value) as a relevant value. In any case, and assuming that this value was retained, the twelve months for AIFs to calculate the asset values of the underlying funds might not be long enough in some cases (eg Start-ups or funds of funds where the AIFM depends on the valuation of the underlying fund's manager).

Question 2

Do you think there is merit in ESMA specifying a single date, for example 31 December 2011 for the calculation of the threshold?

We do not think it makes sense that ESMA sets a single date as "cut-off date" to define the initial threshold of application of the Directive nor for the subsequent anniversaries of that date, since not all funds use the same fiscal year. It would make more sense to establish an annual recalculation, as long as each AIF can choose the specific date.

Question 3

Do you consider that using the annual Net Asset Value calculation is an appropriate measure for all types of AIF, for example Private Equity or real estate? If you disagree with this proposal, please specify an alternative approach.

ASCRI believes that the use of the NAV is not appropriate in the case of Private Equity. The NAV is an accounting measure and not very significative in the case of assets with reliable market valuations. In the case of PE, it would be more befitting to retain the cost of acquisition as a significant value, deducting, where applicable, any amounts already distributed to investors.

Question 4

Can you provide examples of situations identified by the AIFM in monitoring the total value of assets under management which would and would not necessitate a recalculation of the threshold?

ASCRI believes it would be enough with the annual monitoring of the value of assets under management to determine the compliance by threshold. The nature of the assets in which private equity invests and the use of the cost of acquisition as relevant measure make difficult, if not impossible, to manipulate the value that requires a more frequent monitoring.

III.II. Leverage and calculation of assets under management

The questions raised by ESMA only make sense if we consider the use of the NAV as a relevant criterion. As has been stated, ASCRI believes that this is not the value, but the acquisition cost, which must be retained. **Only in case that the NAV was finally the retained value,** these are the ASCRI statements to selected questions.

Question 7

Do you consider that valid foreign exchange and interest rate hedging positions should be excluded when taking into account leverage for the purposes of calculating the total value of assets under management?

ASCRI does not believe that the positions of exchange rate and interest should be included in the calculation basis of the degree of leverage, i.e the degree of exposure of the fund, precisely because they are hedging positions and no added risk through increase of exposure, which is what the calculation of leverage measures.

Question 8

Do you consider that the proposed requirements for calculating the total value of assets under management set out in Boxes 1 and 2 are clear? Will this approach produce accurate results?

The calculation measures proposed in Box 1 are reasonably clear, provided that each fund can use methods of calculation to measure their investment strategy, and the leverage of the portfolio companies are excluded from the calculation (obviously, if there is not liability of the AIF).

IV. Operating conditions: additional capital and liability professional insurance

Question 9

The risk to be covered according to paragraph 2 (b) (iv) of Box 6 (the improper valuation) would also include valuation performed by an appointed external valuer. Do you consider this as feasible and practicable?

ASCRI does not consider neither feasible nor appropriate to include asset valuations conducted by an external valuer among the risks covered by professional liability insurance. Only the risks associated with the activity of the AIFM or persons under the control of AIFM should be covered by professional liability insurance. Otherwise, there are not currently in the market insurance policies of professional liability which cover risks as described.

Question 10

Please note that the term "relevant income" used in Box 8[1] includes performance fees received. Do you consider this as feasible and practicable?

ASCRI does not consider neither feasible nor appropriate to include any fees, including performance fees, within retained earnings to calculate the additional equity. Management fee and performance fees received are not a meaningful indicator of the risk assumed by the AIFM in the case of PE (which is a very long term investment) and, in any case, the variable character of the performance fees would make calculation impossible.

Question 15

Would you consider it more appropriate to set lower minimum amounts for single claims, but higher amounts for claims in aggregate per year por AIFs with many investors (e.g. requiring paragraph 2 of Box 9 only for AIFs with fewer than 30 investors)? Where there are more than 30 investors, the amount in paragraph 3 (b) would be increased e.g. to €3.5 m, while for more than 100 investors, the amount in paragraph 3 (b) would be increased e.g. to €4m

ASCRI considers that ESMA has correctly identified the existence in the insurance policy of limits on the amounts of individual claims and claims added in an annual period. ASCRI supports the proposal contained in the ESMA Box 9, and believes that limits should be retained, but not refer them to a specific number of investors (a single claim can affect 100 investors, for example).

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[1] BOX 8: Cuantitative Requirements. Regarding the Option 1and Option 2, ASCRI would like to point that the preferred Option is Option 2 ("The additional own funds requirements for liability risk is equal to 0.0015% of the value of the portfolios of AIF managed by the AIF plus 2% of the relevant income" BUT without including performance fees -answering Question 10-).

IV. II. General Operating Conditions

Question 17

Do you agree with Option 1 or Option 2 in Box 19? Please, provide reasons for your view.

ASCRI considers that the contractual agreements typically reached between managers and PE investors ensure that, in almost all cases, the investors impose strict conditions in order to assure fair treatment, and this is the best protection possible. Therefore, ASCRI opposes both options proposed by ESMA, as they go significantly beyond what level 1 is providing for.

IV. VII. Operating conditions: organizational measures: control risk function

Questions 18 and 19

Question 18. ESMA has provided advice as to the safeguards that it considers AIFM may apply so as to achieve the objective of an independent risk management function. What additional safeguards should AIFM employ and will there be any specific difficulties applying the safeguards for specific types of AIFM?

Question 19. ESMA would like to know which types of AIFM will have most difficulty in demonstrating that they have an independent risk management function? Specifically what additional proportionality criteria should be included when competent authorities are making their assessment of functional and hierarchal independence in accordance with the proposed advice and in consideration of the safeguards listed?

ASCRI wishes to state that the imposition to AIFM that develop private equity activities of an independent risk management function is redundant: the entire activity of the PE Funds is subject to risk control, at the time the investment is carried out as well as during the life of the investment and when divesting. The imposition of an independent risk management function would be impossible to comply with. Additionally, for small and medium size PE Funds, which typically have small teams in which each of the managers assumes directly risk control management functions of their portfolios, the requirement of this figure may represent a disproportionate cost.

V. Depositaries

In general, ASCRI considers that the "Depositary" figure is completely alien to the private equity sector which, by the nature of its investments, is not exposed to any risk that could be alleviated by the imposition of obligations and enhanced responsibilities of a Depositary. The figure of the Depositary in the case of PE Funds has a role to play in the case of cash monitoring of cash flows and deposits (movements of cash, investments, current subscriptions or redemptions, treasury, etc.).

Question 25

How difficult would it be to comply with a requirement by which the general operating account and the subscrition /redemption account would have to be oponed at the depositary? Would that be feasible?

The sector already operates through finacial institutions, which centralize the cash monitoring of the PE funds, and would not present any degree of complexity requiring that the operating account and subscriptions and redemptions have to be open within the bank (since they already are and this is what the AIFMD requires). Nevertheless, since purusant to the AIFMD PE Funds are not required to use banks as depositaries it will be impossible to hold cash with such depositary.

Question 26

At what frequency is the reconciliation of cash flows performed in practice? Is there a distinction to be made depending on the type of assets in which the AIF invests?

In the current private equity practice, banks do not provide any reconciling service of the cash accounts, since it is the own AIFM which carefully watch over this: capital calls are made to carry out investments, and these are made as soon as the investors have made their draw downs (and, consequently, these are available so managers can make the investments). Therefore, reconciliation is immediate.

Question 33

Under current market practice, which kinds of financial instrument are held in custody (according to current interpretations of this notion) in the various Member States?

[This is part of the AIFMD level 1. Thus all AIFMD compliant funds are required to have a depositary. The only open question is the scope of such depositary's work. (We all know that it is useless, but we have to live with it.)] ASCRI believes that the obligation of custody of the AIF assets should be confined exclusively to the treasury and the financial instruments defined in Annex I of the MiFID. Private Equity investments in Spain are made in companies whose "shares" are not issued in most cases and, when they are issued, they are not securities that could be held in custody.

Madrid, September 13th 2011